

The Honorable Stephen L. Johnson  
Administrator  
U.S. Environmental Protection Agency  
Ariel Rios Building  
1200 Pennsylvania Avenue, N.W.  
Washington, D.C. 20460

Dear Mr. Johnson:

Enclosed for your consideration is the Report of the Small Business Advocacy Review Panel (SBAR Panel or the Panel) convened for the proposed rulemaking “Renewable Fuel Standards 2” (RFS2) that the U.S. Environmental Protection Agency (EPA or the Agency) is currently developing.

On July 9, 2008, EPA's Small Business Advocacy Chairperson (SBAC) convened this Panel under Section 609(b) of the Regulatory Flexibility Act (RFA) as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA) of 1996. In addition to the Chair, the Panel consisted of the Director of EPA's Assessment and Standards Division within the Office of Transportation and Air Quality, the Chief Counsel for Advocacy of the Small Business Administration, and the Administrator of the Office of Information and Regulatory Affairs within the Office of Management and Budget.

The Panel's findings and discussion are based on the information available during the term of the Panel. EPA is continuing to conduct analyses relevant to the proposed rule, and additional information may be developed or obtained during the remainder of the rule development process and from public comment on the proposed rule. Any options the Panel identifies for reducing the rule's regulatory impact on small entities may require further analysis and/or data collection to ensure that the options are practicable, enforceable, environmentally sound, and consistent with the Clean Air Act, primarily sections 202(1) and 183(e).

#### Small Entities That May Be Subject to the Proposed Regulation

##### Gasoline and Diesel Fuel Refiners

EPA's current assessment is that 21 gasoline and diesel fuel refiners meet SBA's criterion of having 1,500 employees or less. It should be noted that because of the dynamics in the refining industry (i.e., mergers and acquisitions) and decisions by some refiners to enter or leave the gasoline market, the actual number of refiners that ultimately qualify for small refiner status under the RFS2 program could be much different than these initial estimates.

#### Summary of Small Entity Outreach

Before beginning the formal SBREFA process, EPA actively engaged in talking to entities that would potentially be affected by the upcoming rulemaking. EPA began well in

advance of the SBREFA process conducting phone conferences and face-to-face meetings with various parties throughout the fuel industry, including small refiners, to discuss the changes made by the Energy Independence and Securities Act and how these changes would affect the RFS program. This helped lead to the selection of a set of potential SERs that represent a cross-section of small refiners.

EPA provided each business with EPA/SBAC fact sheets on the SBREFA process and background information on and the rulemaking process and the upcoming RFS2 proposed rule itself. Once potential SERs were identified, EPA began having more discussions to better understand the needs of the small entities in more detail.

On June 3, 2008 EPA held a two-hour outreach meeting with potential SERs. All eight of the potential SERs participated in the meeting (in person and by phone). These outreach meetings were held to provide the potential SERs with information on the SBREFA process and the role of a SER, and to solicit feedback from the potential SERs on the upcoming rulemaking. After the Panel convened on July 9, 2008, a second outreach meeting was held on July 30, 2008 with the SERs (the potential SERs became SERs once the Panel convened). Seven SERs participated in the meeting by phone. Following each of the outreach meetings, comments were received from the SERs; a summary and full text of these comments can be found in the Panel report.

### Regulatory Approaches

As required by section 211(o) of the Clean Air Act, as amended by the Energy Independence and Security Act of 2007 (EISA), 36 billion gallons of renewable fuels are required to be blended into gasoline and diesel fuel by the year 2022. To meet this requirement, obligated parties must comply with four “nested” standards (total renewable fuel, advanced biofuel, cellulosic biofuel, and biomass-based diesel). Of the 36 billion gallons of total renewable fuels mandated by EISA for 2022, 21 billion gallons of that must be advanced biofuel; of the 21 billion gallons of advanced biofuel required, 16 billion gallons must be cellulosic biofuel and 1 billion gallon must be biomass-based diesel. For the RFS2 proposed rule, EPA intends to propose amending the RFS1 program regulations to implement the new EISA requirements. EPA anticipates that the RFS2 program will continue to use many aspects of the RFS1 program (such as the Renewable Identification Number system), but amendments to the regulations will be needed to account for additional changes made by EISA, including additional definitions (for the new renewable fuel categories), lifecycle GHG reduction thresholds, etc. EPA is considering an implementation date of January 1, 2010.

### Panel Findings and Discussion

The Panel assessed each of the issues raised in the outreach meetings and in written comments by the SERs. The Panel also discussed regulatory approaches and agreed to request comment in the proposed rulemaking on such issues.

### Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Proposed Rule

Registration, recordkeeping and reporting are necessary to track compliance with the RFS2 requirements and transactions involving RINs. These compliance requirements under the RFS2 program will likely be similar to those required under the RFS1 program. Program registration for the RFS1 program uses the same basic forms that EPA uses under the reformulated gasoline (RFG) and anti-dumping program, as these forms are well known in the regulated community and are simple to fill out. Reporting under the RFS1 program currently uses a simplified method of reporting via EPA's Central Data Exchange (CDX), and records related to RIN transactions may be kept in any format and the period of record retention by reporting parties is five years, similar to other EPA fuel programs.

#### Other Relevant Federal Rules Which May Duplicate, Overlap, or Conflict With the Proposed Rule

The primary federal rules that the Panel notes are related to the proposed RFS2 rule under consideration are the Mobile Source Air Toxics rule (*Federal Register Vol. 72, p. 8428, February 26, 2007*) and the first Renewable Fuel Standard (RFS1) rule (*Federal Register Vol. 72, p. 23900, May 1, 2007*). The Panel is also aware of a Technical Amendment Direct Final Rulemaking for RFS1, which EPA expects to be published by early Fall 2008.

#### Regulatory Alternatives

The Panel considered a wide range of options and regulatory alternatives for providing small businesses with flexibility in complying with the RFS2 standards. As part of this process, the Panel requested and received comment on many ideas that were suggested by both the Panel members and the SERs. Taking into consideration the comments received on these ideas, as well as additional business and technical information gathered from and about potentially affected small entities, the Panel summarizes the major options below. The complete set of recommendations can be found in section 9 of the full Panel Report.

#### Major Panel Recommendations

##### Regulatory Flexibility Options

###### Delay in Standards

The RFS1 program regulations provide small refiners who operate small refineries as well as small refiners who do not operate small refineries with a temporary exemption from the standard through December 31, 2010. Small refiner SERs suggested that an additional temporary exemption for the RFS2 program would be beneficial to them in meeting the standards. EPA evaluated a temporary exemption for at least some of the four required RFS2 standards for small refiners. The Panel recommends that EPA propose a delay in the effective date of the standards until 2014 for small entities, to the maximum extent allowed by the statute. However, the Panel recognizes that EPA has serious concerns about its authority to provide an extension of the temporary exemption for small refineries that is different from that provided in CAA section 211(o)(9), since Congress specifically addressed an extension for small refineries in that provision.

Phase-in

Small refiner SERs' suggested that a phase-in of the obligations applicable to small refiners would be beneficial for compliance, such that small refiners would comply by gradually meeting the standards on an incremental basis over a period of time, after which point they would comply fully with the RFS2 standards. EPA has serious concerns about its authority to allow for such a phase-in of the standards. CAA section 211(o)(3)(B) states that the renewable fuel obligation shall "consist of a single applicable percentage that applies to all categories of persons specified" as obligated parties. This kind of phase-in approach would result in different applicable percentages being applied to different obligated parties. Further, as discussed above, such a phase-in approach would provide more relief to small refineries operated by small refiners than that provided under the small refinery provision.<sup>1</sup> Thus the Panel recommends that EPA should invite comment on a phase-in, but not propose such a provision.

RIN-related Flexibilities

The small refiner SERs requested that the proposed rule contain provisions for small refiners related to the RIN system, such as flexibilities in the RIN rollover cap percentage and allowing all small refiners to use RINs interchangeably. Currently in the RFS program, EPA allows for 20 percent of a previous year's RINs to be "rolled over" and used for compliance in the following year. A provision to allow for flexibilities in the rollover cap could include a higher RIN rollover cap for small refiners for some period of time or for at least some of the four standards. Since the concept of a rollover cap was not mandated by section 211(o), EPA believes that there is an opportunity to provide appropriate flexibility in this area to small refiners under the RFS2 proposed program but only if it is determined that there is a disproportionate effect warranting relief. The Panel recommends that EPA request comment on increasing the RIN rollover cap percentage for small refiners, and further that EPA should request comment on an appropriate level of that percentage. The Panel recommends that EPA should invite comment on allowing RINs to be used interchangeably for small refiners, but should not propose this concept because under this approach small refiners would arguably be subject to a different applicable percentage than other obligated parties.

Program Review

With regard to the suggested program review, EPA raised the concern that this could lead to some redundancy since EPA is required to publish a notice of the applicable RFS standards in the Federal Register annually, and that this annual process will inevitably include an evaluation of the projected availability of renewable fuels. Nevertheless, the SBA and OMB Panel members believe that a program review could be helpful to small entities in providing them some insight to the RFS program's progress and alleviate some uncertainty regarding the RIN system. As EPA will be publishing a Federal Register notice annually, the Panel recommends that EPA include an update of RIN system progress (e.g., RIN trading, RIN availability, etc.) in this notice and that the results of this evaluation be considered in any request for case-by-case hardship relief. The Panel also recommends that EPA work with DOE in the development of DOE's small refinery

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<sup>1</sup> Additional extensions under section 211(o)(9) are discussed below. To the extent a phase-in may be an appropriate form for an extension under that provision, the Panel recommends that it be considered in that context.

study, specifically to communicate the comments that SERs raised during the Panel process.

*Extension of Existing RFS1 Temporary Exemption*

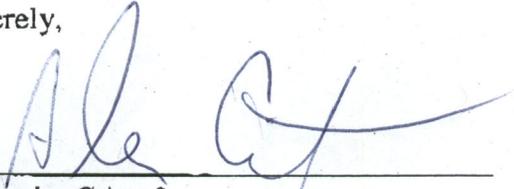
The Panel recommends that EPA propose in the RFS2 program the provision at 40 CFR 80.1141(e) extending the RFS1 temporary exemption for at least two years for any small refinery that DOE determines would be subject to disproportionate economic hardship if required to comply with the RFS2 requirements.

*Petitions for an Extension Based on Disproportionate Economic Hardship*

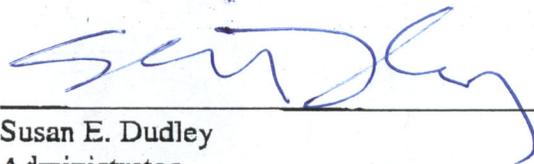
While SERs did not specifically comment on the concept of hardship provisions for the upcoming proposal, the Panel notes that under CAA section 211(o)(9)(B) small refineries may apply to EPA for case-by-case extensions of the small refinery temporary exemption on the basis of disproportionate economic hardship. The Panel recommends that EPA propose in the RFS2 program a case-by-case hardship provision for small refineries similar to that provided at 40 CFR 80.1141(e)(1). The Panel also recommends that EPA propose a case-by-case hardship provision for small refiners that do not operate small refineries that is comparable to that provided for small refineries under section 211(o)(9)(B), using its discretion under CAA section 211(o)(3)(B). This would apply if EPA does not adopt an automatic extension for small refiners, and would allow those small refiners that do not operate small refineries to apply for the same kind of extension as a small refinery. The Panel recommends that EPA take into consideration the results of the annual update of RIN system progress.

The purpose of the Panel process is to solicit information as well as suggested flexibility options from the SERs, and the Panel recommends that EPA continue to do so during the development of the RFS2 rule. Recognizing the concerns about EPA's authority to provide extensions to small refineries different from that provided in section 211(o)(9), the Panel recommends that EPA continue to evaluate this issue, and that EPA request comment on its authority and the appropriateness of providing extensions beyond those authorized by section 211(o)(9) for small refineries operated by a small refiner. The Panel also recommends that EPA propose to provide the same extension provision to small refiners who do not operate small refineries as is provided for small refineries.

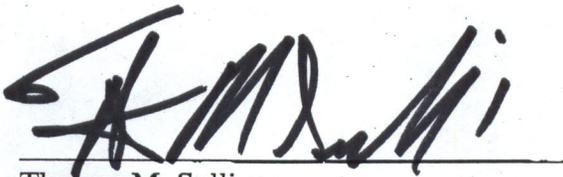
Sincerely,



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Enclosure